



*Memoranda Journal Entries*  
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# **CIRA Study Course**

## **Part 2: Plan Development**

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## Chapter I

### Valuation Approach

Most valuations determining adequate protection will be based on the assumption that the business is a going concern. Several approaches may be used to determine the value of collateral pledged as security for an allowed claim, including replacement costs, discounted cash flows or earnings, earnings or cash flow multiples, etc. Assets in businesses not expected to reorganize use liquidating values.

For individual assets the value will be determined based on the future cash flows expected from that asset. Thus the value for account receivables pledged as security under a floating lien arrangement might be based on the estimated collectable receivables. In the case of inventory pledged where there is an active market for the inventory, the first value generally considered is replacement costs. Where the product is unique, the value may be based on the amount expected to be realized from the sale of inventory after selling costs and normal profit margins. The value of the stock of a subsidiary is based on the projected cash flows from the business less interest bearing debt. The approaches to the determination of value will vary depending on the circumstances in each case.

### Claim Determination

Valuation issues need to be addressed in the determination of several types of claims. Among them are secured, recourse and election to have the entire claim considered secured.

#### Secured Claims

Under section 506 of the Bankruptcy Code the bankruptcy court may hold a hearing to determine the amount of the claim that is secured and unsecured for undersecured claims. A secured claim is allowed for the value of the collateral and an unsecured claim for the amount of the claim in excess of the value of the collateral. The unsecured part of the claim may be included in the same class as other unsecured claims or, in certain situations, placed in a separate class. Often, the creditor and the debtor will agree on the how the claim is divided between the secured and unsecured part without a hearing. Notice of the agreement will be filed with the court, and unless parties in interest object the court will normally allow the claim as filed.

#### Nonrecourse Considered Recourse

Section 1111(b) allows a secured claim to be treated as a claim with recourse against the debtor in chapter 11 proceedings (that is, where the debtor is liable for any deficiency between the value of the collateral and the balance due on the debt) whether or not the claim is nonrecourse by agreement or applicable law. This preferred status terminates if the property securing the loan is sold under section 363, is to be sold under the terms of the plan, or if the class of which the secured claim is a part elects application of section 1111(b)(2).

## Chapter VII

problems faced by the business. It has failed to ask questions most important for the survival of the business such as:

- What products are most profitable?
- What are strengths and weaknesses of the company?
- What areas should be expanded? Liquidated?
- In what areas do the real potential for this business lie?
- What direction should this business take?

The greater the financial problems, the more time management devotes to day-to-day details, and almost no time is spent on providing direction for the company. A properly developed business plan is critical to the development of a reorganization plan.

### 9. Determination of Reorganization Value

One of the first and most difficult steps in reaching agreement on the terms of a plan is determining the value of the company. Long-term cash flow projections are helpful in determining the reorganization value of the emerging entity. In fact, if the parties involved in the case can agree on the cash flow projections for the next 5 years or so, it is much easier to determine the reorganization value of the company. Once the parties--debtor, unsecured creditors' committee, other creditors' committee (if appointed), secured creditors, and equity holders--agree on the reorganization value, this value is then allocated among the creditors and equity holders. Obviously, the reorganization value of the debtor must be known before the amount unsecured, secured and equity holders will receive is determined. These parties are generally unable and often unwilling to agree to the terms of a plan proposed by the debtor without some indication of the value of the company that will emerge from bankruptcy.

To provide the information needed by creditors and stockholders to effectively evaluate the proposed plan, the accountant may prepare a pro forma balance sheet showing the impact the proposed plan will have on the financial condition of the company. This pro forma balance sheet is most helpful if it contains the reorganization value rather than historical costs. Thus the assets will be shown at their current values and any excess of the reorganization value over individual assets will be shown. In the pro forma balance sheet, liabilities should be shown at their discounted values and stockholders' equity should be shown at fair value based on the assumption the plan will be confirmed.

If the parties involved in a chapter 11 case agree on the assumptions underlying the business plan, the long-term cash projections and the resulting reorganization value of the company that will emerge from chapter 11, successful negotiations on the terms of a plan should not be too difficult.